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C O N F I D E N T I A L SECTION 01 OF 03 RANGOON 001184

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TREASURY FOR OASIA JEFF NEIL
USPACOM FOR FPA

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TAGS: EFIN ETRD ECON PGOV BM
SUBJECT: BURMA SANCTIONS: BUSINESSES ADAPTING IN A FROZEN ECONOMY

REF: RANGOON 1118 AND PREVIOUS

Classified By: COM CARMEN MARTINEZ FOR REASONS 1.5 (B,D)

¶1. (C) Summary: Many businesses have adapted fairly well to the July economic sanctions on Burma, though overall economic activity has dropped notably. Many have embraced trade in euros, while some have sought to move their traditional dollar-based business to the Thai and Chinese borders. Still others are settling their transactions outside of Burma. Despite these attempts to adapt, none of these alternatives is perfect. Sanctions will have a long-term impact on the economy; however, in the absence of economic reforms, the Burmese government remains by far the largest enemy of the Burmese economy. End summary.

Eur-OK With Me

¶2. (C) Nearly two months since the introduction of additional wide-ranging Burma sanctions -- banning imports of Burmese goods into the United States and forbidding provision of financial services to Burma by U.S. persons -- most Burmese traders have settled on one of three options for survival. The first option is to try and shift all import and export contracts from the U.S. dollar to a different currency, predominately the euro. Prior to the new sanctions, the U.S. dollar was the currency of choice for all international transactions. However, the financial services ban, combined with the skittishness of most foreign banks to do any U.S. dollar business with a Burmese entity, have forced Burmese banking authorities and import-export firms to scramble for alternatives.

¶3. (C) The GOB has accommodated desperate traders to some degree. As reported in reftel, in mid-August the Commerce Ministry informally issued instructions to banks and entrepreneurs to amend values of goods in existing U.S. dollar export and import licenses, and all future licenses, in Euro, Japanese Yen, or Singapore dollars "for opening L/Cs and for payments." Government trade banks are also allowing businesses to open accounts in these alternative currencies. Though the government banks will still issue dollar-denominated L/Cs, they are forcing the Burmese customer to sign a letter assuming all risk of loss.

¶4. (C) After some confusion and chaos surrounding the sudden shift, the situation has settled considerably as the majority of companies that must use the banking system are reluctantly opening euro accounts and negotiating with buyers and sellers to alter their terms of business. Some large traders have even applauded the move, citing the relative stability and strength of the euro.

¶5. (C) There are at least three major flaws in this system, which contributed to the initial sharp drop in trade volume following the imposition of sanctions (though there has been some rebound in recent weeks). First, some traders unfamiliar with the euro, and suspicious of the government's policies, have been reluctant to make the switch, instead basically ceasing their legal trading operations. Second, some foreign exporters -- particularly in Asia -- want payment in U.S. dollars, and are charging a 6-7 percent premium to amend contracts into euros to cover foreign exchange risk. Interestingly, Burmese importers with whom we spoke seemed totally unaware of the OFAC license allowing for U.S. dollar financial transactions pursuant to exports to Burma. Finally, the euro has little use on the street here. No black market has evolved and the government banks are not allowing euro account holders to withdraw their euros -- only to convert to U.S. dollars and then withdraw them as normal in Foreign Exchange Certificates. The euro only has value to traders who can use their euro export earnings to get euro-denominated import licenses from the government -- which requires importers to have foreign exchange in the bank to cover any imports.

Run For the Border

¶6. (C) The second option, for businesspeople trading with China or Thailand, is an expansion of border trade operations

-- both licit and illicit -- which can be done in several currencies without relying on L/Cs. This is an imperfect solution. While it avoids the euro hassles, it entails additional transportation and other "administrative" costs. Traders are not able to move the same volume of product that they had previously imported or exported via container. This method is also not a good substitute for those dealing in large capital goods. Though the GOB is easing settlement procedures for legal border trade, permission to import remains tightly controlled. Though rumors persist that the government will liberalize import licenses for border commerce, this has not yet occurred. Traders report that for legal border transactions they still must contend with the increasingly tight-fisted import license process administered by the Ministry of Commerce, and directed by SPDC Vice Chairman General Maung Aye.

¶7. (C) Because of these obstacles, legal border trade has not increased much since sanctions -- though many traders are setting up shop in border entrepots. However, we've heard that there has already been an expansion of black market importing. With diminishing legal trade, due both to the sanctions and the government's continued tight control on import licenses, shortages of consumer goods and some commodities (such as rubber resin) have appeared in Rangoon. When possible, traders have seized on these shortages to expand their importing of the needed product, import license or no, to fill the gap.

Keeping it at Arm's Length

¶8. (C) A final option for traders, particularly exporters, is to conduct settlements in U.S. dollars outside of Burma -- primarily in Singapore and Hong Kong. Traders report that two Singaporean banks in particular are being used to settle L/Cs in U.S. dollars via intra-bank transfer between a Myanmar Foreign Trade Bank (MFTB) account and the account of a buyer/seller in the same bank. The offshore U.S. dollars are either kept abroad or remitted to Burma using hundi. Burmese entrepreneurs tell us that so far the GOB is accepting this method of settlement, provided the proper import licenses are held and export taxes are paid. However, one well-connected trader opined that the government will have to crack down on this soon, as it is reducing the amount of hard currency coming into Burma.

Comment: Sanctions Can't Take the Whole Blame/Credit

¶9. (C) Despite the fact that Burma's wily business community is adapting to the new economic realities, the sanctions will have some long-term negative impact on the economy. Traders are unanimous that without counterbalancing economic reforms, sanctions will contribute to a significant decline in overall trade volume (though an increase in border trade will make up some of this decline) and a net outflow of foreign exchange. Many export-focused manufacturers and small trading companies may go under -- with possible benefits for larger, better connected firms. Price increases are also a real possibility with the shortages of imported goods, especially those not easily replaceable via border trade. However, the chilly business environment and persistent banking problems will also keep money supply and velocity sluggish, which may continue to hold down inflationary pressures.

¶10. (C) However, it is important to remember that sanctions are not the only, or even the primary, cause of Burma's economic troubles. Traders with whom we spoke blame the government's ongoing tightfisted import license policy, where approvals run at only 25-50 percent of requests, as much as sanctions for the bleak trade picture. Also, businessmen have confided in us that they, and many of their colleagues, are leaving the country for "awhile" or easing back on their business operations because they find operating in the current business climate too treacherous. Their discontent comes not only from the chaos caused by sanctions, but also from the general mismanagement of the economy by the government, and the GOB's increasingly aggressive policy of pressuring businesses to take on unprofitable or risky deals in the "national interest."
Martinez